FUNDAMENTAL ANALYSIS DEPARTMENT

S-REITS INDUSTRY REPORT

NUS INVESTMENT SOCIETY

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Contents

Introduction

Singapore-listed Real Estate Investment Trust (REIT) offer investors access to a diversity of real estate assets including retail malls, office buildings, industrial properties, hotels, serviced apartments and hospitals. It allows investors to invest in professionally managed real estate assets through purchase of unit trusts, similar to a company's common stock. REITs usually raise money through an initial public offering (IPO), banks loans or subsequently private share placements to fund and purchase their properties. These properties are then rented out to tenants and in return, these rentals are paid out to unit holders as dividends. Unit holders of a REIT will usually receive dividends at regular intervals as the REIT income is derived from property rentals.

The objective of investing in REITs is usually to obtain dividend income as Singapore's Inland Revenue Authority (IRAS) has a policy of requiring REITs to distribute 90% of their income to unit holders each year in order to be exempted from taxes.

Key Metrics for Analysing REITs

Distribution Yield

The first thing that most investors would look out for when investing in a REIT is their distribution yield. A REIT has to distribute at least 90% of their distributable income. Generally, industrial REITs tend to have the highest yield while having the lowest possibility of capital appreciation. They also tend to be the most susceptible to economic downturns. On the other hand, retail REITS tend to have the lowest yields as they are more resilient to economic downturns and thus more sought after by investors. Yield and share prices move inversely, hence when the share price of a REIT increases, its distribution yield decreases.

Management Fees

As a REIT investor, it is important for us to find out whether the interests of the REIT's manager are aligned with that of the REIT's unit holders. We can look out for any potential conflicts of interests from the compensation plan of the REIT's manager. There are three types of management fees; namely base fees, performance fees and acquisition and divestment fees. These fees vary from manager to manager. Management fees are charged by the REIT manager for managing the REIT and helping to distribute the income to the unit-holders. A base fee ranging from 0.1% to 0.5% is charged regardless of the performance of the REIT. Managers are also rewarded with a performance fee when they meet certain targets. Acquisition and divestment fees are charged every time a property is bought or sold. This ranges from 0.5% to 1.5% of the transacted amount. It is important for investors to do peer comparison for the industry to see whether the manager charge overly extravagant fees for unit holders.

Equity Funding

REITS are highly geared vehicles and they are mandated to distribute at least 90% of its distributable income every year, which leaves little retained income for acquisition and asset enhancement initiatives (AEI). As such, a REIT might have to raise more equity for major acquisitions. This can be done via a rights issue, where unit-holders subscribe to more units by injecting capital. Thus, as REIT investors, we need to be prepared to increase our investment so that our stake in that particular REIT does not get diluted. Another way to raise funds is via a private placement whereby units are placed to institutional investors. The downside is that existing unit-holders who do not get to participate will face a dilution in their shareholdings.

Performance of S-REITS at a Glance

The Singapore Real Estate Market can be considered as having one of the strongest fundamentals in the Asia-Pacific region. We expect this to continue in the long run, despite a slowdown across the globe, e.g. Europe, Japan, China. The fact that the Real Estate Sector remains relatively unaffected after the Federel Reserve ended its asset purchase program on October 2014 shows us the relative strength of the local Real Estate market. Singapore's reputation as a global financial centre is also helping to ensure that the commercial real estate market stays strong.

The outlook for the retail segment remains fairly positive despite a decline of 3% in international visitor arrivals. This was partly due to a 30% drop in China tourist when the Chinese government tightened regulations on overseas travel. Growing income levels of locals as well as interest from international retailers will help ensure stability in this region.

As evidenced, prices of office space increased by 1.6% in 2014Q3, rentals of office space rose 2.6% in 2014Q3, following a 2.8% increase in 2014Q2. Rentals of retail space increased by 0.1% in 2014Q3, compared to the 0.6% increase in 2014Q2.

The industrial segment will remain stable throughout 2015 and 2016, owing to plentiful supply of space. 9.1% of 42.3 mil sq m of industrial space is vacant in 2014Q3. However, there is potential for a slight decrease in rental rates due to oversupply as evidenced by the fact that prices and rental of industrial space fell 0.9% and 1.8% in 2014Q3 respectively.

With a 1.0% decline in the previous quarter, prices of private residential properties further decreased by 0.7% in 2014Q3. This is the fourth straight quarter of price decline. Meanwhile, rentals of private residential properties fell by 0.8% in 2014Q3, more than the 0.6% decline in 2014Q2. This is probably due to the government property cooling measures.

Overall, demand across office, retail and industrial segments remain robust, given Singapore's ability to attract large amounts of foreign investments, its strong consumer sentiments and strong economic growth.

Sector Outlook

Industrial REITS

Seven of the world's Industrial REITs are listed on Singapore Exchange (SGX) and account for approximately 15% of the S$98 billion in global market capitalisation represented by the sector. They are namely— Ascendas REIT, Mapletree Logistics Trust, Mapletree Industrial Trust, Cache Logistics Trust, AIMS AMP CAPITAL Industrial REIT, Cambridge Industrial Trust and Sabana Shari'ah Compliant REIT.

These seven REITs are also constituents of FTSE ST All-SHARE Index. They have a combined market capitalised of S$14.5 billion. Their average and median 2014 year-to-date total return stood at 11.0% and 12.3% respectively. The table below details these seven REITs.

Name	SGX Code	Market Cap S$ M	Px Chg Pct YTD %	Total Return	Total Return	Dvd Ind Yld %
ASCENDAS REAL ESTATE INVESTMENT TRUST	A17U	5673.6	7.3	12.5	10.7	6.0
MAPLETREE LOGISTICS TRUST	M44U	2905.6	11.4	18.6	17.2	6.5
MAPLETREE INDUSTRIAL TRUST	ME8U	2479.7	8.6	19.8	14.7	6.9
CACHE LOGISTICS TRUST	K2LU	919.9	6.3	9.4	12.3	7.2
AIMS AMP CAPITAL INDUSTRIAL	O5RU	913.6	6.4	12.0	12.4	6.9
CAMBRIDGE INDUSTRIAL TRUST	J91U	903.0	4.3	17.0	9.9	7.0
SABANA SHARIAH COMP IND REIT	M1GU	712.4	(5.6)	(2.0)	(0.1)	7.3

Source: Bloomberg

These seven Industrial REITs listed in Singapore maintain an average price-to-earnings (P/E) ratio of 11.0 - which compares to the global median of 11.7. Meanwhile the average and median price-to-book ratio of the seven Industrial REITs listed in Singapore is 1.1 and 1.2 versus 1.4 and 1.2 respectively.

The average indicative dividend yield of the Industrial REITs in Singapore is 6.8% versus the global average of 5.1% and global median of 5.2%. The average debt-to-asset ratio as of the last filing according to Bloomberg was 32.2% for the Singapore REITs versus the world median of 38.5% and world average of 38.7%.

The key issue facing the Industrial market is the upcoming supply of c.2.1m sqm p.a. over the next three years. We forecast excess supply in the key sub-segments of multi-user factories, warehouses and business parks. In light of the demand supply imbalance over the coming two to three years, we expect rental reversions to moderate or turn negative from 2015. On the demand side, while leasing momentum has slowed near term, uptake of space remains solid. Despite the weaker outlook, we still expect positive DPU growth for the sector. This is mainly due to the impact from recently announced acquisitions, developments or significant rental reversions (e.g. Cache upon expiry of master lease in 2015). In addition, strong economic growth in Singapore and higher growth in the US also contributes to the positive DPU growth trend. It is estimated that at least 30-40% of the tenants of industrial S-Reits cater directly to demand in the US.

Office REITS

The office sector has traditionally been regarded as pro-cyclical and high-beta (i.e. risky). The irony is that the office cycle in Singapore has now turned countercyclical, with office rents now recovering from the bottom of the cycle and starting to appreciate, when rental growth for other segments appears to be moderating (retail and industrial) or still in decline (hospitality). Meanwhile, office S-REITs are still trading at distinct discounts to their book values, PBRs (from book values as at end-2013) of 0.78-0.82x compared with the weighted-average

PBR of 0.94x for the overall S-REIT sector. We believe the PBR discrepancy is not justified and expect it to narrow if the rental growth trend continues to diverge.

Since June 2006, the average PBR of the office S-REITs has been, on average, 0.20x lower than the weighted-average PBR of the S-REIT sector. We believe the PBR difference could narrow further under the scenario of a strong office-rent recovery, such as the exceptional period from mid-2006 to early 2007 when the average PBR of office S-REITs traded on a par with the S-REIT sector and significantly above 1x.

The current consensus view is that the outlook for the office sector is bright due to the lack of supply in 2015 and we concur that market conditions remain conducive for further rental hike expectations into 2015. While we are also positive on the office sector near term, we caution investors from being too exuberant. The new space is being taken up by non-traditional sectors such as e-commerce, insurance and IT which require small-to medium-sized floor plates. The significant driver of office rents has historically been the financial sector with large floor place requirements. However, demand from finance firms is currently muted as several foreign banks are scaling down their operations.

Hospitality REITS

As reported in Fitch, tourist arrivals into Singapore are likely to remain weak in 2015, due to softer economic growth in China and higher inflation in Indonesia - two key inbound markets for Singapore. However Fitch expects the ratings of CDL Hospitality Trust (BBB-/Stable) and Far East Hospitality Trust (BBB-/Stable) to remain unchanged next year, on the back of moderate leverage and robust financing flexibility.

Moving forward, with the political situation in Thailand stabilising and the adverse reaction to MH370's disappearance dissipating over time, we believe Chinese tourists who have avoided Thailand and Malaysia and in turn Singapore (Chinese tourists typically visit Thailand, Malaysia and Singapore as part of a tour) recently, may look to return to Southeast Asia over the coming year. This trend can be seen in the latest Thai Ministry of Tourism data which indicate a marked reduction in the decline of Chinese arrivals in August. We expect a similar trend for Singapore in the upcoming STB tourist arrival data.

Retail REITS

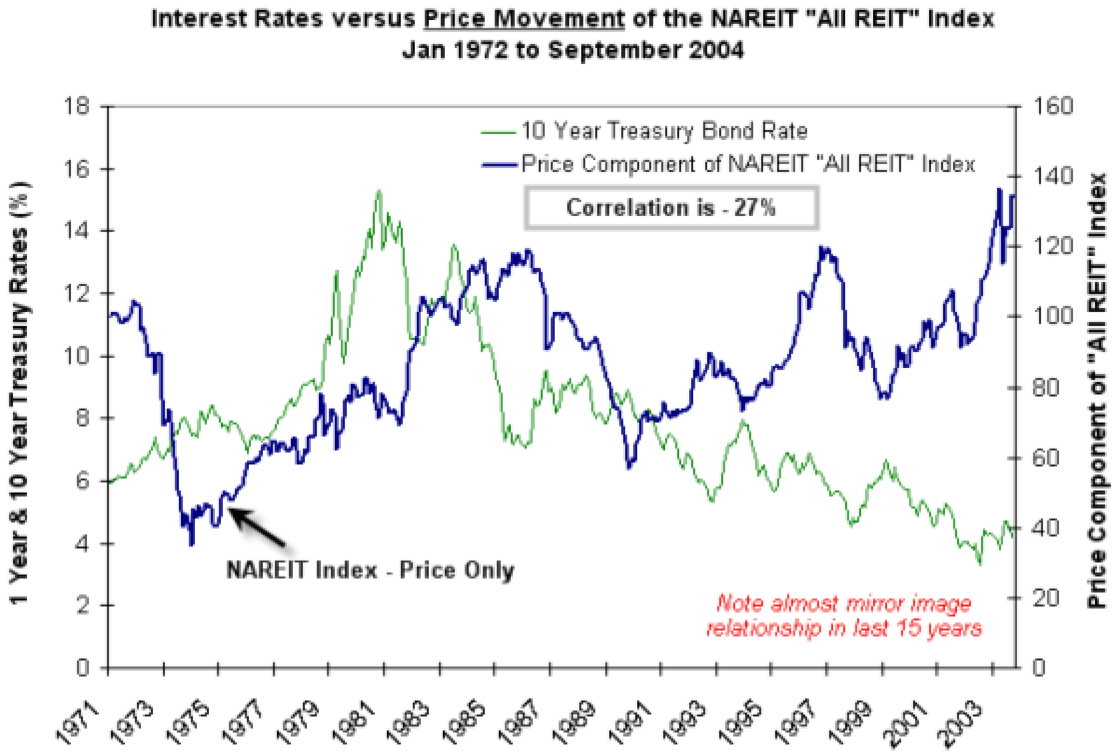
Despite continued wage growth, retail sales in Singapore, as indicated by the Retail Sales Index (RSI), have been declining over the past few quarters. We believe the "leakage" of retail spending has been caused by (1) higher overseas travel due to the strong SGD and prevalence of low cost carriers, and (2) increased popularity of online shopping among Singapore consumers. Even though the retail landscape has been weak lately, retail landlords (using CMT as a proxy) have still been able to achieve positive rental reversions due to the entry of foreign brands into Singapore and active management of tenant mix (e.g. higher share of F&B outlets).

However, we believe retail malls' ability to lift rents will become increasingly weak as retail tenants consolidate and downsize their operations in the face of slowing sales, inability to attract labour (tighter foreign labour restrictions from July 2015) and rising costs (higher worker levies and wages to attract staff). In fact, there is risk that rental reversions could fall below inflation after 2015. Partially shielding the REITs from the near-term impact of lower tenant sales is the staggered lease expiry schedule which will delay the impact on the REITs. In addition, selective malls such as Vivocity and Causeway Point, with their proven track records or monopolistic positions, could benefit from the consolidation.

Macroeconomic Factors Affecting REITs

Rising Interest Rates

As a high yield instrument, REITs are expected to be sensitive to interest rate changes. Majority of the S-REITs are well insulated against rising interest rates in the short term due to them taking on fixed interest rate debt. As the FED seeks to increase interest rates in view of a recovering economy, we expect the re-financing cost of the debt to increase in the near future. Ceteris paribus, an increase in financing cost may lead to a drop in its distribution per unit (DPU). Distribution per unit is derived after deducting certain expenses such as administrative cost and interest payments. We expect REIT prices to decrease to reflect the expectations of higher interest rate; future cash flows of the REIT are subjected to a higher required rate of return due to increased cost of financing.



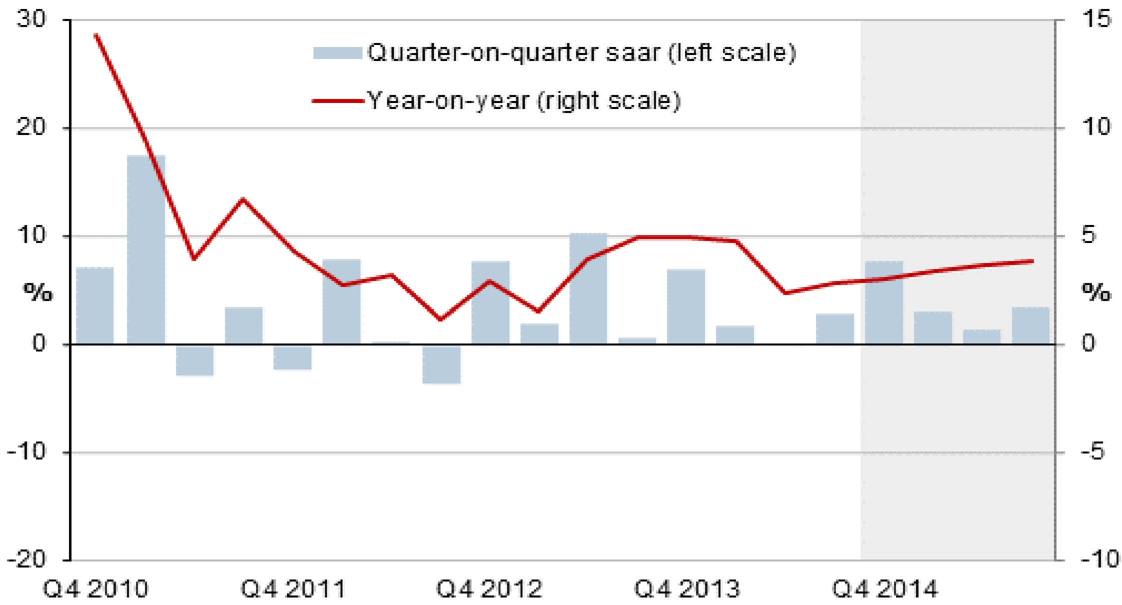
Source: Investopedia

As shown above, there is a negative correlation between REITs and interest rates. It is safe to assume that rising interest rates are to be met with a decline in REIT prices.

While the increase in interest rate is a concern, it is equally important to note that interest rate hikes are normally accompanied by better economic growth. Furthermore, REITs are usually able to soften the impact by having diversified funding sources and duration. Higher growth in turn will likely push up the demand for commercial real estate, improve occupancy rates and rental income. Hence, any increase in cost of borrowing may be offset by the landlord’s ability to raise rental rates. In this context, management remained confident and optimistic over their trust's stable credit ratings and healthy gearing ratio to offset the impact of rising interest rates in the short term. Management continue to actively manage their financing costs by diversifying their sources of funding and reduce the lumpiness of their trust's debts maturing in any one year. Hence, REITS can be still attractive, given their yield spreads of 3.2% against 10 year government bond yields.

Singapore's Economy and Foreign Direct Investment

Singapore's economy expanded by a middling 2.4% year-on-year (y-o-y) in Q314 according to initial estimates, failing to match market expectations of a 2.8% expansion. In sequential terms, the economy experienced a modest pick-up from its Q214 performance, growing at a 1.2% quarter-on-quarter, seasonally adjusted rate (q-o-q SAAR). The result paints a picture of an economy dealing with myriad headwinds ranging from weak external demand to domestic labour market pressures. According to the Ministry of Trade and Industry (MTI), growth is expected to be around 3% in 2014 and 2-4% in 2015. This is significantly lower than the 6.8% average growth enjoyed over 2010-2013 as shown in the graph below. With core inflation sliding below 2%, we believe that there could be a heightening of caution and slower growth experienced in the REITS sector.



Source: Ministry of Trade and Industry (MTI) and FocusEconomics Consensus Forecast

In terms of foreign direct investment (FDI), Singapore dominates the region; and we expect this to continue in 2015. Various factors that make Singapore attractive to foreign investments: solid economic fundamentals, political stability and a transparent business environment. Foreign investors use Singapore as a gateway to enter into other Asian economies. In recent years, Singapore has managed to secure major investments in high value-added sectors such as education, medical, IT, electronics, biomedical, aerospace and pharmaceuticals. With the influx of high quality foreign direct investments, there has been a strong interest to own properties with reputable tenants in Singapore.

The REITS sector continues to play an important role to cater for such demands. Singapore's REIT environment is particularly well developed in the Asian context, and the market is the second largest after Japan. Most other regional REIT markets are extremely immature and small in size; and thus Singapore, with its globalised financial markets, appears as an attractive choice for overseas investors and developers. We expect to see this trend to continue, in the medium term at least. Many Singapore-listed REITs have diversified holdings of properties both locally and overseas. An avid investor Shanghai based billionaire property developer Tong Jinquan holds substantial holdings in Singapore-listed REITS such as Cambridge Industrial Trust, Sabana REIT, Croesus Retail Trust and Lippo Malls Indonesia Retail Trust. This shows that there is a strong confidence of foreign investors for Singapore-listed REITS.

Stock Profiles

Croesus RTrust (S6NU.SI)

Current Price: SGD 0.90
Target Price: SGD 1.00(+11.1%)

Croesus Retail Trust (CRT) is an Asia-Pacific retail business trust with an initial portfolio located in Japan. CRT's principal investment strategy is to invest in a diversified portfolio of predominantly retail real estate assets located in the Asia-Pacific region, with an initial focus on Japan.

Key Financials

Market Capitalization (SGD mil)	460.6
Shares Outstanding (mil)	430.0
Average Daily Volume (mil)	1.12
Free Float (%)	95.77
52-Wk High	1.02
52-Wk Low	0.87
P/E (ttm)	9.10

	2014A	2015F
P/E (x)	6.91	18.72
P/B (x)	1.03	1.10
ROE (%)	14.99	7.05
Div Yield (%)	11.58	8.49
D/E (%)	125.34	132.76
EBITDA (M)	58.08	56.00
EPU (SG cents)	14	6
DPU (SG cents)	8.98	8

Source: Bloomberg

Japan's Promising Macro-Environment

Croesus Retail Trust offers investors exposure to Japan's inflating property market. Just last year, Moody's Japan K.K. has revised the outlook on Japan's real estate industry from negative to stable. The change in the sector outlook is reflects the value appreciation of Japan's commercial properties, as well as increasing rents throughout the REIT sector which is shown in Croesus RT's increasing property valuations. The weak yen coupled with the 10 year Japanese government bond yield of around 0.6% will push investors towards the attractive REIT market which has a relatively high dividend payout.

Given the stable outlook, volatility in long-term interest rates and the proposed increased tax hike in 2015 could pressure the outlook in the next two to five years.

However, CRT's debt profile is fully hedged from any possible interest rate hikes, effectively shielding the trust from adverse financing costs in the near future.

Sustainable High Dividend Yield

Croesus Retail Trust is committed to distribute 100% of its net income as dividends from the date of listing 1st July 2014 to 30th June 2015, and subsequently, at least 90%. Given that CRT hedged 80% of its distribution income for two projected periods, Future dividend payout is expected to not deviate too much from its current value.

However, with the JPY near 10 year low with the SGD, DPU is expected to experience significant erosion. CRT has extended it hedge 80% distributional income for the fiscal year 2015.

Croesus Growth Prospects

Since its IPO, Croesus Retail Trust has acquired additional 2 properties, Croesus Shinsaibashi and NIS wave I. All of Croesus RT's properties are located near major roads and train networks which make it relatively accessible. Croesus's portfolio of properties has a Weight Average Lease Expiry of 10 years (by Net Lettable Area) and approximately full occupancy rate. Contracts for an estimated 60% of its NLA will expire beyond 2018. This goes to show that its property rental income is unlikely to face a significant decline in the foreseeable future. The trust also has a Right of First Refusal for another two assets – Mallage Saga and Kyoto Forecast Kawaramachi. This gives the trust a significant room for expansion.

Executing its Growth Strategy in upcoming period

CRT announced the acquisition of ONE's mall for JPY11bn (S$132.5m) which is at a 5.2% discount to the JPY11.6bn (S$139.8m) independent valuation with an initial NPI yield of 5.8%. One Mall is freehold, large scale retail complex (NLA of 52,844 sqm) located in Inage World within Chiba City, which is 40km Southwest of Tokyo. As of end -Jun 14, occupancy and WALE stood as 99.4% and 5.8 years respectively. The mall is home to 52 diversified tenants and located next to a major road and in an area served by three major lines.

Keppel REIT (K71U.SI)

Current Price: SGD 1.21
Target Price: SGD1.30 (+7.44%)

Keppel REIT is one of the largest real estate investment trusts (REITs) listed on the Singapore Exchange Securities Trading Limited (SGX-ST) with assets under management of approximately $6.9 billion as at 30th September 2014. Its portfolio include interests in nine premium office assets with 11 office towers strategically located in the central business districts of Singapore, and key cities of Sydney, Melbourne, Brisbane and Perth in Australia.

Key Financials

Market Capitalization (bil)	3.66
Shares Outstanding (mil)	3002
Average Daily Volume (mil)	4.17
Free Float (%)	58.29
52-Wk High	1.30
52-Wk Low	1.11
P/E (ttm)	5.2

Source: Bloomberg

	FY11A	FY12A	FY13A	FY14A
P/E (x)	3.09	8.85	5.6	5.22
P/B (x)	0.62	0.98	0.92	0.85
ROE (%)	11.61	9.78	14.53	16.64
Div Yield (%)	4.564	6.228	6.396	5.595
D/E	62.02	69.90	68.81	60.40
EBITDA	55.92	59.25	59.48	65.47
EPS (SG cents)	22	13	20	23
DPS (SG cents)	6.17	7.77	7.88	7.47

Favourable Demand for Office Space

The average occupancy rates for Grade A office space in the core Central Business District (CBD) area remained steady at 96.6% according to a report done by CBRE. Rental growth in the CBD core market is positive, where Grade A rents rise by 3.3% q-o-q to $10.95 psf per month in 3Q2014. Rental rates and leasing demand are expected to remain positive over the next few quarters, due to low vacancy rates and steady demand.

The Australian Bureau of Statistics has recorded a y-o-y economic growth of 3.1% in 2014Q2. The Reserve Bank of Australia (RBA) expects GDP to be 3.0% for 2014. Interest rates are expected to remain at 2.5% to sustain demand and economic growth. The office leasing activity in Australia is expected to improve in 2014 and 2015, where companies in the professional services and technology-related sectors are expected to undergo expansion. The office markets are expected to generate new leasing demand as an estimated of 4-5% of office stocks could potentially be withdrawn from the CBD office markets over the next few years.

Accretive acquisition of a third interest in Marina Bay Financial Centre (MBFC) Tower 3

Keppel REIT announced the proposed acquisition of a one-third interest in two-year-old MBFC Tower 3 on 18th September 2014. The acquisition will improve Keppel REIT's average portfolio age to 5.5 years and lengthen the weighted average lease expiry for the top 10 tenants and overall portfolio to 9.2 years and 6.4 years respectively. This will in turn strengthen Keppel REIT's position as a leading landlord of premium Grade A office buildings in Singapore's CBD core area. Keppel REIT is expected to fund the acquisition partly through a placement and using the sales proceeds from the divestment of the 16 year old Prudential Tower. Keppel REIT is expected to have an aggregate leverage ratio of about 43.8% after the acquisition is completed.

Positive rental reversion and a strong committed portfolio occupancy rate

Net property income growth is positive at 16.1% y-o-y to $117.2 million for YTD Sept 2014. Distributable income for YTD Sept 2014 grew 0.7% y-o-y to $160.3 million. DPU for 3Q and YTD September 2014 stood at 1.85 cents and 5.72 cents respectively, equivalent to an annualised distribution yield of 6.4%. Rental reversions were positive at 32.3% and tenant retention rate was high at 92% in 3Q 2014. Committed occupancy levels remained strong at 99.3% for its entire portfolio. 48% and 16% of borrowings due in 2015 and 2016 respectively have been refinanced early, with no further requirements for the next 14 months. About 72% of borrowings are on fixed-rate and the all-in interest rate is low at 2.2%.